



## POSTAL REGULATORY COMMISSION

### 39 CFR Part 3035

[Docket Nos. RM2017-1 and RM2022-2; Order No. 6043]

RIN 3211-AA29

### Competitive Postal Products

**AGENCY:** Postal Regulatory Commission.

**ACTION:** Supplemental notice of proposed rulemaking.

**SUMMARY:** On January 3, 2019, the Commission adopted final rules to implement a dynamic formula-based approach for calculating the institutional cost contribution requirement for Competitive products, which is also referred to as “the appropriate share,” in accordance with the applicable statutory requirements. Subsequently, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit), in a decision issued in April 2020, remanded two issues to the Commission for clarification. This supplemental notice of proposed rulemaking addresses the issues identified by the D.C. Circuit, initiates the Commission’s third 5-year review of the appropriate share, reissues the dynamic formula-based approach to calculating the appropriate share as a proposed rule, and invites public comment.

**DATES:** *Comments are due:* February 25, 2022; *Reply Comments are due:* March 25, 2022.

**ADDRESSES:** For additional information, Order No. 6043 can be accessed electronically through the Commission’s website at <https://www.prc.gov>. Submit comments electronically via the Commission’s Filing Online system at <http://www.prc.gov>. Those who cannot submit comments electronically should

contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section by telephone for advice on filing alternatives.

**FOR FURTHER INFORMATION CONTACT:** David A. Trissell, General Counsel, at 202-789-6820.

## **SUPPLEMENTARY INFORMATION:**

### **Table of Contents**

- I. Relevant Statutory Requirements
- II. Background
- III. Basis and Purpose of Proposed Rule
- IV. Proposed Rule

### **I. Relevant Statutory Requirements**

Section 3633(a)(3) of title 39 of the United States Code requires the Commission to “ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.” 39 U.S.C. 3633(a)(3). Section 3633(b) requires that the Commission revisit the appropriate share regulation at least every 5 years in order to determine if the minimum contribution requirement should be “retained in its current form, modified, or eliminated.” 39 U.S.C. 3633(b). In making such a determination, the Commission is required to consider “all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products.” *Id.*

### **II. Background**

Pursuant to section 3633(b), the Commission initiated Docket No. RM2017-1 for the purpose of conducting its second review of the appropriate share requirement since the enactment of the Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006). In its second review of the appropriate share, the Commission found that market conditions

have changed since the PAEA's enactment and since the Commission's last review of the appropriate share.<sup>1</sup> Most significantly, the parcel delivery market has experienced a significant increase in demand, particularly over the last 5 years, due to the growing prevalence of e-commerce. Order No. 4963 at 5-12. This has led to steady increases in revenue and profit for all competitors in the market, as well as growth in competitive volumes and market share for the Postal Service. *Id.* In light of the changes described above, Order No. 4963 adopted a dynamic formula-based approach to determining the appropriate share and adopts related rule changes. *Id.* at 19-29.

However, Order No. 4963 was appealed by the United Parcel Service, Inc. and later remanded to the Commission for further consideration by the United States Court of Appeals for the District of Columbia Circuit. *United Parcel Serv., Inc. v. Postal Reg. Comm'n*, 955 F.3d 1038 (D.C. Cir. 2020). The court identified two major aspects of Order No. 4963 for the Commission to clarify on remand.

First, the court found that “the Commission ha[d] not adequately explained how the statutory phrases ‘direct and indirect postal costs attributable to [a particular competitive] product through reliably identified causal relationships’ and ‘costs...uniquely or disproportionately associated with any competitive products’ can coincide.” *Id.* at 1041, 1049. Second, the court found that “in focusing narrowly on costs attributed to competitive products under [39 U.S.C.] 3633(a)(2), the Commission failed to discharge its responsibility under [39 U.S.C.] 3633(b) to ‘consider...the degree to which *any* costs are uniquely or

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<sup>1</sup> See Docket No. RM2017-1, Order Adopting Final Rules Relating to the Institutional Cost Contribution Requirement for Competitive Products, January 3, 2019, at 4-12, 114-170 (Order No. 4963); see 84 FR 537 (January 1, 2019).

disproportionately associated with any competitive products.” *Id.* at 1042, 1049 (emphasis in original).

As part of Order No. 6043 and to provide necessary background concerning the issues identified by the court, Chapter IV of the Order details the evolution of postal costing. The current cost attribution methodology is designed to facilitate the attribution of costs to products to the greatest extent feasible. See Section IV.A.1. The Commission discusses the nature of institutional costs and why they cannot be allocated any further. See Section IV.B.4. With respect to Competitive product regulation, the Commission explains how section 3633, as implemented by the Commission, functionally results in a series of interrelated price floors. See Section IV.B. The price floor required by 39 U.S.C. 3633(a)(2), which requires each Competitive product to recover its product-level attributable costs, is included in the calculation of the price floor under 39 U.S.C. 3633(a)(1), which requires the recovery of both product- and group-level attributable costs for Competitive products collectively. See Section IV.B.2-3. This is because incremental costs<sup>2</sup> currently form the basis for both cost attribution and testing for cross-subsidization of Competitive products by Market Dominant products. See *id.* Therefore, the price floor under paragraph (a)(1) is currently equivalent to the total attributable cost of Competitive products collectively, which includes both individual product-level incremental costs as well as group-level costs that are incremental for Competitive products collectively. See *id.*

Chapter V discusses the regulatory scheme for Competitive products and amplifies the Commission’s interpretation of 39 U.S.C. 3633(a)(3) and (b).

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<sup>2</sup> Incremental costs are the variable and fixed costs that would be eliminated if a product or group of products were discontinued, or, equivalently, the total cost caused by the product or group of products. See Section IV.B.2.

Based on the PAEA's text, context, and structure, and as confirmed by its history, the purpose of the appropriate share provision is to ensure fair competition in the market for competitive postal services by protecting against any possibility that prices for the Postal Service's Competitive products (despite covering their attributable costs), might nevertheless be anticompetitively priced as a result of the Postal Service's institutional costs being jointly incurred by Market Dominant and Competitive products. See Section V.B. The Commission concludes that the primary focus of the appropriate share provision is to protect competition rather than to ensure a particular level of institutional cost coverage. See *id.*

The Commission clarifies that the "uniquely or disproportionately associated" standard appearing in 39 U.S.C. 3633(b) is broader than the "reliably identified causal relationship" standard for cost attribution under 39 U.S.C. 3631(b), such that the latter standard can be viewed as a subset of the former. See *id.* The Commission also, as directed on remand, considers the "uniquely or disproportionately associated" standard as applied to all accrued costs, which includes both attributable and institutional costs. See *id.* To rise to the level of being "uniquely or disproportionately associated with any competitive products" as contemplated by 39 U.S.C. 3633(b), the cost's relationship with the product or products must be *distinct* (uniquely associated) or *out of proportion* compared to the cost's relationship with other products or groups of products (disproportionately associated). See *id.*

Chapter VI applies the Commission's interpretation to "all relevant circumstances," resulting in the Commission electing to maintain the dynamic formula-based approach to determining the appropriate share. Under 39 U.S.C. 3633(a)(3), the prices set for Competitive products must be marked up high enough to generate revenue above and beyond the costs attributable to

Competitive products at the individual product and group level in order to also cover an appropriate share of the Postal Service's institutional costs. See Section VI.A.1. The price floor set by 39 U.S.C. 3633(a)(3) is made up of the appropriate share of institutional costs, as determined by the Commission, plus the attributable cost of Competitive products collectively. See *id.* Thus, this price floor set by 39 U.S.C. 3633(a)(3) is higher than both of the price floors set by 39 U.S.C. 3633(a)(1) and (a)(2). See *id.* Because all attributable costs are already included in the Competitive product price floor under 39 U.S.C. 3633(a)(3), the Commission declines to further account for them as part of the appropriate share. See *id.* Double-counting such costs would be economically unsound and would undermine the Postal Service's ability to effectively compete. See *id.*

The Commission applies the "uniquely or disproportionately associated" standard to all of the Postal Service's accrued costs. See Section VI.A. The Commission has analyzed the degree to which any costs are "uniquely or disproportionately associated with any competitive products," (39 U.S.C. 3633(b)), and found there are no costs (other than those that also meet the definition of attributable costs) that can be identified to be "uniquely or disproportionately associated with any competitive products." 39 U.S.C. 3633(b); see Section VI.A.1.

The nature of the residual costs which remain in the institutional cost category is such that the relationships between such costs and specific products or groups of products are not discernible or quantifiable. See *id.* There is no method to identify a portion of institutional costs as associated with Competitive products that would not be arbitrary and capricious. See Section VI.A.2. Moreover, employing arbitrary cost allocation methods would seriously undermine the Postal Service's ability to compete. See *id.*

The inability to further allocate institutional costs under the current methodology, however, does not mean that the Postal Service has an unfair competitive advantage with respect to Competitive products. *See id.* The available evidence suggests that the market is healthy and competitive. *See id.*; Section VI.B.2. There is no evidence that the Postal Service has engaged in anticompetitive pricing of Competitive products; to the contrary, the evidence suggests that the Postal Service is incentivized to maximize Competitive product profits, and its market conduct has been in line with what would be expected of a profit-maximizing firm. *See* Section VI.A.2. Competitive product contribution to institutional costs has always exceeded the required amount, often by a significant margin.<sup>3</sup> The Commission has elected to retain the appropriate share to serve as a margin of safety against any possibility of the Postal Service having an unfair competitive advantage. *See* Section VI.A.2. Under the proposed dynamic formula-based approach, the appropriate share requirement would increase due to growth in the profitability or market share of the Postal Service's Competitive products. *See id.*

With the foregoing clarifications having been made, the Commission explains how the formula operates and how it accounts for the prevailing competitive conditions in the market and other relevant circumstances that the Commission has historically considered qualitatively when evaluating the appropriate share requirement. *See* Section VI.B. Because the dynamic formula-based approach reasonably reflects the qualitative statutory criteria from 39 U.S.C. 3633(b), it easily falls within the Commission's broad discretion to determine what the appropriate share should be. *See* Section VI.B.1. The

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<sup>3</sup> *See id.* (citing FY 2020 ACD at 91-95; FY 2019 ACD at 86-89; FY 2018 ACD at 112-17; Order No. 4402 at 52-53 (83 FR 6758, Feb. 14, 2018)).

Commission concludes that the appropriate share requirement, as derived from the formula, is sufficient to prevent the possibility of the Postal Service engaging in anticompetitive pricing of Competitive products. See Section VI.B.1.c.

### **III. Basis and Purpose of Proposed Rule**

The purpose of the Commission's dynamic formula-based approach is to provide an objective basis on which to quantify the statutory considerations of section 3633(b) in order to determine the year-to-year change in Competitive products' joint minimal capacity to generate profit that can be contributed to the coverage of institutional costs. Order No. 6043 at 99.

The formula seeks to determine the Postal Service's overall market power by measuring its absolute and relative market power.<sup>4</sup> In order to assess the Postal Service's absolute market power and its market position, the formula utilizes two distinct components. The first component is the Competitive Contribution Margin, which measures the Postal Service's absolute market power. *Id.* at 99-101. Specifically, the Competitive Contribution Margin is calculated by subtracting the total attributable costs of producing the Postal Service's competitive products collectively from the total amount of revenue the Postal Service is able to realize from those competitive products collectively in a given fiscal year, and then dividing this result by the total competitive product revenue. *Id.* at 99-100. The formula assesses the year-over-year percent change in the Competitive Contribution Margin to determine how much, if any, the Postal Service's absolute market power has changed. *Id.* at 100.

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<sup>4</sup> Market power is a firm's ability to price a product or service higher than the marginal cost of producing it and, as a concept, embodies both absolute and relative aspects. *Id.* A firm's absolute market power is its ability to raise prices with regard to its own consumers. *Id.* A firm's relative market power, which can also be described as its market position, is its capacity to exercise market power relative to its competitors. *Id.*



The second component of the formula is the Competitive Growth Differential, which measures the Postal Service's market position. *Id.* at 100-101. Specifically, the Competitive Growth Differential is calculated by subtracting the year-over-year percent change in the combined revenue for the Postal Service's competitors from the year-over-year percent change in the Postal Service's competitive product revenue. *Id.* This relative growth is then weighted by the Postal Service's market share. *Id.* at 100.

Using the above-described components, the Commission's formula is represented by the following equation:

$$AS_{t+1} = AS_t * (1 + \% \Delta CCM_{t-1} + CGD_{t-1})$$

$$\text{If } t = 0 = \text{FY 2007, } AS = 5.5\%$$

Where,

AS = Appropriate Share

CCM = Competitive Contribution Margin

CGD = Competitive Growth Differential

$t$  = Fiscal Year

*Id.* at 102.

In order to calculate an upcoming fiscal year's appropriate share percentage ( $AS_{t+1}$ ), the formula multiplies the sum of the prior fiscal year's Competitive Growth Differential and percentage change in the Competitive Contribution Margin ( $1 + \% \Delta CCM_{t-1} + CGD_{t-1}$ ) by the current fiscal year's appropriate share ( $AS_t$ ). *Id.* Both components of the formula are given equal weight. *Id.* The formula is recursive in order to incorporate all changes in the parcel delivery market since the PAEA was enacted and the appropriate share was initially set. *Id.* at 103. The formula's calculation thus begins in FY 2007 with a beginning appropriate share of 5.5 percent. *Id.* The upcoming fiscal

year's appropriate share will be updated by the Commission each year as part of the Commission's Annual Compliance Determination, which is performed pursuant to 39 U.S.C. 3653. *Id.*

Because another 5 years has passed since the Commission's review began in Docket No. RM2017-1, Order No. 6043 also initiates the Commission's third 5-year review via Docket No. RM2022-2. Because the issues and facts under review are related, the two dockets are consolidated to enable more efficient administration of proceedings before the Commission. See 39 U.S.C. 503; 39 CFR 3010.104.

#### **IV. Proposed Rule**

In order to implement the Commission's formula, existing § 3035.107(c) is reissued. Proposed § 3035.107(c)(1) establishes the formula that is to be used in calculating the appropriate share and defines each of the formula's terms. Proposed § 3035.107(c)(1) states that the appropriate share of institutional costs to be covered by competitive products set forth in that rule is a minimum contribution level. Proposed § 3035.107(c)(2) establishes the process by which the Commission shall update the appropriate share for each fiscal year. The Commission will annually use the formula to calculate the minimum appropriate share for the upcoming fiscal year and report the new appropriate share level for the upcoming fiscal year as part of its Annual Compliance Determination.

#### **List of Subjects for 39 CFR Part 3035**

Administrative practice and procedure.

For the reasons stated in the preamble, the Commission proposes to amend chapter III of title 39 of the Code of Federal Regulations as follows:

## **PART 3035—REGULATION OF RATES FOR COMPETITIVE PRODUCTS**

1. The authority citation for part 3035 continues to read as follows:

**Authority:** 39 U.S.C. 503; 3633.

2. Amend § 3035.107 by revising paragraph (c) to read as follows:

### **§ 3035.107 Standards for compliance.**

\* \* \* \* \*

(c)(1) Annually, on a fiscal year basis, the appropriate share of institutional costs to be recovered from competitive products collectively, at a minimum, will be calculated using the following formula:

$$AS_{t+1} = AS_t * (1 + \% \Delta CCM_{t-1} + CGD_{t-1})$$

Where:

AS = Appropriate Share, expressed as a percentage and rounded to one decimal place.

CCM = Competitive Contribution Margin.

CGD = Competitive Growth Differential.

t = Fiscal Year.

If t = 0 = FY 2007, AS = 5.5 percent.

(2) The Commission shall, as part of each Annual Compliance Determination, calculate and report competitive products' appropriate share for the upcoming fiscal year using the formula set forth in paragraph (c)(1) of this section.

By the Commission.

**Erica A. Barker,**

*Secretary.*